

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 YEREVAN 000626

SIPDIS

SENSITIVE

EUR FOR CACEN, EUR/ACE FOR LONGI

E.O. 12958: N/A

TAGS: [EAID](#) [ECON](#) [EFIN](#) [AM](#)

SUBJECT: ARMENIA FINALLY TAXING THE RICH?

REFS: A) YEREVAN 52 B) 04 YEREVAN 1899

SENSITIVE BUT UNCLASSIFIED. PLEASE PROTECT ACCORDINGLY.

SUMMARY

1. (SBU) Four months after President Kocharian called for reform of the state tax and customs services, the International Monetary Fund (IMF) and the World Bank have applauded improvements in Armenia's tax collection. The government has increased overall tax collections by 19.3 percent over last year and, most importantly, there has been a 35 percent increase in social payments that has been matched by an increase in pension transfers. IMF Resident Representative Jimmy McHugh told us that his data indicate that much of the rise in VAT and profit tax collections is from large taxpayers, although the burden has increased on small businesses, too. McHugh said that progress on tax and social payment collections makes the lack of progress in Customs reform stand out even more. He said that the Customs Service is trying to squeeze increased revenue from small importers and still favoring large oligarch businesses, a view corroborated by one such large importer. The IMF reports that it is ready to enter into a new three-year arrangement with the GOAM that will concentrate on reforms in the tax and customs services. End Summary.

PRESIDENT: "HIGHER REVENUES, FAIRER COLLECTION"

2. (SBU) In January, the President called for a reform agenda to increase tax revenues in a way that did not chill new investment and growth (ref A). He stressed the need to scotch nepotism and corruption in the system that led to illicit tax privileges for Armenia's oligopolies and harassment and overtaxation of smaller businesses to compensate. In his addresses to the State Tax Service and State Customs Committee, President Kocharian spoke candidly about reforming the revenue services to meet the government's twin goals in the fiscal sphere: raising tax revenues in order to support social spending while making the business environment more fair and inviting. He specifically noted that the tax service investigates small and medium sized firms far more often than large firms, despite the fact that large firms pay an incommensurately small share of the tax burden. At the time, business associations and the press welcomed the President's initiative to crackdown on Armenia's oligopolistic economy.

TAX REVENUES AND SOCIAL PAYMENTS ARE UP

3. (SBU) The IMF Resident Representative and the head of the World Bank office in Armenia told us on April 5 that the government's renewed efforts to improve tax audit functions and the transfer of social security payments to the tax service (which can then crosscheck labor and tax data) has raised tax collection by 19 percent over last year. Social contributions have risen significantly as the tax authorities now are charged to collect social payments from employers at the same time they collect other taxes. Also, a drop in simplified tax collection, which was created for small businesses but exploited by large ones to evade taxation, suggests that the tax service is collecting more revenues from larger firms as they are move under the appropriate tax regime. Domestic collection of VAT grew by 37 percent, which the IMF representative attributed to large companies coming off the simplified tax regime into the regime of VAT and profit taxes.

BUSINESS ASSOCIATIONS CITE TAX REFORM'S MIXED RECORD

4. (SBU) Members of the American Chamber of Commerce (who are largely representatives of American-owned small and

medium sized firms) told us that they have seen no difference in the tax collections, inspections or in their liabilities, adding that they have consistently been the favorite subjects of tax audits anyway. For its part, the Armenian Merchants Union and Union of Manufacturers and Entrepreneurs (which consists of Armenian-owned firms, some of which are large) told us that since the President ordered reform of the tax administration in early January, their members have complained that the tax service has more frequently inspected, refused to accept valid tax reports, and pressured companies to inflate their tax liabilities in order to deter future inspections.

CUSTOMS LESS KEEN ON REFORM

15. (SBU) The IMF Resident Representative said that he "felt" that the increase in Customs Revenues was less due to reform and largely due to squeezing small importers. A large importer of foodstuffs (not American) who admits to regularly bribing customs in exchange for preferential treatment confirmed this, saying he is receiving the same deal as always. (Note: The deal--Customs will value his import at USD 500 rather than the USD 900 that they have set for a ton of his product (regardless of the invoice price), and then he and the customs officials split the 32 percent VAT and tariff that he would have paid on the remaining USD 1400. That is, he pays Customs USD 64 under the table for each ton of imports of this product. He added that for tax purposes his firm then under-invoices the onward sale of the product to account for the undocumented expense of the bribe to customs. End Note.)

16. (SBU) Besides creating personal revenue for customs officials, the way that imports are priced and taxed allows Armenia's well-connected oligarchs to maintain monopolies on trade in basic food and consumption items (ref B). Reform of the Customs Service would have a strong impact on the Armenian economy far beyond raising government revenues, but the opposition of well-placed oligarchs who benefit from preferential import arrangements will make reform of the Customs Service difficult to realize.

IMF PROPOSES NEW ARRANGEMENT

17. (SBU) The IMF plans to agree on a new three-year arrangement with the GOAM that will focus on reforms of the tax and customs services and the financial sector. The new IMF program will require the GOAM to strengthen the audit function in the tax service and improve the large taxpayers unit. The IMF Resident Representative James McHugh told us that a precondition for the first payment from the IMF is that the GOAM publish the top 300 corporate taxpayers, so that everyone can see who is paying and who is not. When the State Tax Service publishes its list of large taxpayers in April 2005, it is important that it include the oligarchs, lest the tax crackdown reinforce public distrust of the tax administration and the cat-and-mouse culture of tax collection and evasion. McHugh pointed to the success of publishing the top 100 corporate lossmakers, which he said cut the claimed losses by two thirds. The IMF will also require that the GOAM demonstrate that the Customs Service is using invoices to determine import tariff and VAT liabilities at the border, removing the Customs Service's primary tool of corruption.

COMMENT: EQUAL TREATMENT MATTERS

18. (SBU) We were skeptical of President Kocharian's commitment to improving tax collection, despite his strong rhetoric. We concur with the IFI's that results are impressive, at least for now. There is enough slack in enforcement of Armenia's tax law that the government can significantly increase revenues just by bringing more of the untaxed economy into the tax system without raising the tax liabilities of those who actually pay taxes now. The World Bank estimates Armenia's shadow economy as 43-53 percent of Armenia's GDP in 2004. Capturing this shadow economy in the tax system is sure to draw complaints from large and small businesses alike; not only oligarchs evade taxation. Nevertheless, it is good news that the State Tax Service appears willing to take on large taxpayers who have long evaded taxation, rather than selectively enforcing a tax crackdown against small businesses only. Reform of the Customs Service will be harder, because the oligarchs depend on special treatment to keep would-be competitors' products uncompetitive. Besides discouraging new investment, the failure to maintain an equal tax environment creates an anti-competitive economy that perpetuates Armenia's oligopolies, which in turn put off potential market entrants and would-be taxpayers.

EVANS